

MAZARS Central and Eastern European Tax Guide 2018

- The region's governments are giving an increasing role to consumption-type taxes: boosting collection efficiency is a major objective in most of the countries
- Total labour cost remains high; the situation in Hungary has improved, but families continue to benefit most
- In two-thirds of the region taxpayers are allowed to prepare IFRS-based separate financial statements and to use these for taxation purposes
- Levels of corporate income tax and the methods for calculating the tax base vary widely across the region
- With the growth of documentation obligations, transfer pricing regulations are also becoming more stringent

Budapest, 31 May 2018 – It is with great pleasure that we announce the sixth edition of the MAZARS Central and Eastern European Tax Guide. Our report on the current taxation regimes of the CEE is now expanded from 19 to 22 countries: beyond the countries of the region, Russia, Ukraine and the Baltic states, this year's issue also includes Bulgaria, Kosovo and Germany. The purpose of this publication is to help investors compare the fundamental factors of competitiveness.

Value Added Tax

Thanks to the positive economic climate of recent years, **government budget deficits have improved and consumption has started to increase** in most CEE states. Governments are trying to build upon this momentum by **giving an increasingly prominent role to consumption-type taxes** when planning fiscal revenues.

Accordingly, **one of the most important sources of income is value added tax**. Owing to EU regulations the rules are mostly harmonized, but the tax rates applied **vary widely** across the region. The average normal VAT-rate is around 20%; in 2018, only Montenegro increased its top VAT rate by a few percentage points. **The 25% and 27% rates** in Croatia and Hungary, respectively, **are still particularly high**.

Also signalling the budgetary importance of value-added taxes is the widespread **introduction of modern digital technologies aimed at boosting the efficiency of VAT collection** and reducing tax evasion. Such measures include the sectoral introduction of online cash registers and the increased monitoring of transport related transactions (e.g. the Hungarian Electronic Public Road Trade Control System). From 2018 in Hungary **billing software must be connected to the tax authority's system**, thus facilitating real-time electronic reporting.

Taxes On Employment

The proportion of taxes and contributions on labour continues to decrease in the region; **however, the total labour cost for employers is still close to 160% of net wages**. Traditionally

underperforming in comparisons regarding burdens on labour, Hungary **has somewhat improved its position** although the recent significant reductions benefit families exclusively.

It is worth noting that as of 2018, the Romanian system of social contributions has been completely overhauled. Furthermore, this year **Romania, Croatia and Montenegro each found ways to decrease personal income tax rates.**

Corporate Income Tax

The difference between the lowest and the highest tax rates **is as high as 20 percentage points**, but methods for **calculating the tax base vary widely**, hence corporate income taxes of the studied countries **cannot be compared on tax rates alone.**

This notion is confirmed by the fact that certain countries have **introduced tax schemes altogether different from traditional profit-based taxation.** Previously only Estonia had its own, unique system, whereby companies did not have to pay the 20% corporate tax as long as there was no withdrawal of income from the company. As of 2018 Latvia has chosen a similar path, and has also **made distributed profits part of the tax base.**

Across other CEE countries, **the differences in the emphasis placed on corporate income tax** are increasingly apparent. This year in Croatia the corporate income tax rate decreased by a few percentage points, while a few kilometres away in Slovenia **there was a comparable rise.** Overall, the average corporate income tax rate in the CEE region is a little over 17% (calculating with the highest rate in case of countries with a progressive tax system).

All CEE countries with traditional income tax **schemes allow losses generated in previous years to be carried forward and used against the positive tax base of subsequent years.** Generally, this amount can be used for a limited time, usually 5-7 years, but in some countries only for 3-4 years. **Only six countries continue to allow losses to be carried forward indefinitely.**

The majority of the countries examined used some kind of interest limitation rule, which determines **what part of the interest paid on corporate loans can be deducted** from the income tax base.

Thanks to the EU's Anti Tax Avoidance Directive (ATAD), the earlier thin capitalisation regulations are **being replaced by EBITDA-based calculation methods.** The same directive is also driving the standardisation of Controlled Foreign Company (CFC) regulations.

States in the region have **a penchant for imposing withholding taxes on payments of interest, dividends and royalties** (at rates of 15%, or even 19-20%). Naturally, these may be applied with attention to the provisions of the relevant tax treaties. At the same time, **Lithuania, Estonia and Hungary continue not to impose withholding tax on capital gains.**

In two-thirds of the CEE region, taxpayers are allowed to prepare IFRS-based separate financial statements and to use these **also for taxation purposes.** This has been a marked trend of recent years. Finally, it should be noted that in more than half of the countries the tax system **supports research and development (R&D) activities** in some form or another.

Transfer Pricing, CBC-R

OECD's BEPS ("base erosion and profit shifting") initiative has drawn attention to the fact that tax authorities **should concentrate more on intra-group and, possibly, cross-border transactions.**

Transfer pricing regulations have already been introduced to the tax systems of almost all the countries concerned, and now **there is a growing emphasis on the accompanying documentation obligations.** The fundamental objective of OECD prescribed country-by-country reporting (CBC-R) is to promote transparency by way of **providing local tax authorities with the information necessary for assessing tax risks.**

In the past year, taxpayers in the CEE region also **had to actively participate in launching the CBC reporting system.**

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